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ASOPs – Public Pension Plan Funding Request for Comments
Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036-4601

Re: ASOPs and Public Pension Plan Funding and Accounting

Dear Actuarial Standards Board Members:

Thank you for seeking comments on this very important topic. The opinions presented in this letter are my own and are not necessarily the views of Gabriel, Roeder, Smith, & Company, or of any of its employees other than the undersigned.

The fundamental question at issue is whether or not there should be ASOPs specifically developed for public plans. Do we need to create additional or different actuarial financial measurements and projections in order to ensure continued solvency of public retirement systems? My answer to that question is “no”. Let me explain why that is.

The fact that such ASOPs are being considered seems to presume that there is a major and universal problem with public plan funding and governance that does not exist in more heavily regulated corporate and multi-employer pension plans. That is not really the case. In fact, most public plans are responsibly operated and reasonably well funded as are most non-public plans. Many public plans reported funded ratios at or exceeding 100% at the turn of the century. Some non-public plans, particularly multi-employer plans, have serious funding problems today. The point is that there are problems in both public and private sector retirement systems. Potential changes in standards need to address all of the problems.

Of course, it is well known that today there are a few severely underfunded public plans, and, that in some cases, benefits have been reduced. I submit that the primary cause of underfunding in the public sector is not a lack of numbers, but rather a lack of money – the simple unwillingness or inability of certain plan sponsors to direct sufficient funding to their plans. We see this with the Social Security system today. All actuaries know, or should know, that the so called Social Security “Trust” funds are expected to be depleted in 2033, and that between now and then, something has to happen. There are plenty of numbers and projections out there about Social Security. I doubt that the public pays much attention to them or understands them or believes them. Problems with the Social Security system were known in the 1970’s, and the program has been subject to a series of amendments in response to those problems, well before ASOP 32 was conceived. Unfortunately, in spite of all the numbers and projections that have existed for many years, and in spite of the actions that have been taken, Social Security still has problems. A new ASOP could not change that, nor could it fix the problems of State and Local governments who choose not to fund, or are unable to fund, their retirement plans.

What should we do as actuaries? We have several choices.

1. **Take no specific additional action** and let the plans and plan sponsors deal with it. Public sector actuaries routinely add disclosures and commentary to their reports that are appropriate to existing conditions, and will continue to do so as new conditions emerge. In response, a good number of public plans have already taken responsible steps to correct the mismatch they see between benefits and available funding in a timely manner. In so doing, they are avoiding the need for larger changes later. Those plans are likely to experience a secure future and to serve their stakeholders well. Governments that don't restore balance to their plans will see failed plans, benefit cuts, municipal bankruptcies, and very angry unions and taxpayers. Public employees, taxpayers, and present and future retirees will bear the consequences. Potentially insufficient retirement benefits for public employees could lead to poverty at older ages, and pressure to *increase* Social Insurance benefits including Social Security.
2. **Create ASOPs specific for Public Plans**. I concede that this is probably going to happen. After all, we actuaries are numbers people, and we can't help but think that more numbers will solve the problem. When I read the Social Security Trustees report, and ponder the human consequences of all of the numbers and projections and information it contains, and consider that the political will to do anything about it seems to be lacking, I can't imagine why we think that more numbers will help public plans. There was an SOA conference on Financial Economics ("FE") and Public Plans a few years ago at which one of my colleagues said "There just is no single number that will make people behave." That statement sounds true to me. If, in fact, we do create new ASOPs for pension plans, we should consider creating them in a manner that provides for applicability beyond just the public plan space and to all types of retirement plans.
3. **Use Existing Tools and Standards to Encourage Sound Governance and Funding.** The actuarial bodies can show much leadership here. A good example of leadership is the CCA-PPC white paper on Public Pension Funding Policy edited by Paul Angelo and Tom Lowman. The actuarial bodies need to do more of that sort of thing, not just at the senior practice level, but at the basic educational level for actuaries. Public plans are very different from private plans from a regulatory, governance, and political standpoint. Our educational syllabus could include a specialty track that trains young actuaries thoroughly in dealing with those differences. The actuarial bodies could offer to work with other organizations, such as the International Foundation of Employee Benefit Plans, the Government Finance Officers Association, the National Conference on Public Employee Retirement Systems, the National Council on Teacher Retirement, and others to offer learning opportunities on these matters to their members. The Financial Economics discipline has much to offer Public Sector plans, but it needs to be offered in a practical manner that unifies people around a common objective. As numbers people, we argue over creating new liability measurements based on various FE principles, without ever asking: "What are the practical and useful applications of financial economics that we should be bringing up with our clients? How can we present FE issues in a way that our clients can understand and accept? What can we do now to make things better?" We need to involve the many highly experienced public sector consultants available to us in this process. They have much to offer. Basically, in my view, we need to get the word out to taxpayers, to plan sponsors, to plan participants, to labor

unions, to public plan fiduciaries, and to any other stakeholders that public plans need sound governance, a sound funding policy (and the political will to follow it), reasonable benefit levels, a good understanding of the nature of risk (i.e., not just a new set of numbers discounted at rates that correspond to the credit rating of the plan sponsor), and a good understanding of the consequences of ignoring risk. We also need to explain the importance of the role defined benefit plans play in an uncertain world.

4. **Encourage Fiscal Responsibility in Government.** In my view, the greatest threat to a public pension plan is not the numbers the actuary calculates, but the balance sheet of the sponsoring government. A government with a strong balance sheet will tend to have a well-funded pension plan. A government with a weak balance sheet will tend to have an underfunded pension plan because, essentially, such governments tend to use the pension plan to solve their unrelated problems. Therefore, to the extent that we can encourage fiscal responsibility and risk control, in general, on the part of sponsoring governments, we will be helping to secure continued solvency of their pension plans, in particular.

In summary, we need to focus on the actual problem, which, in almost every case, has been conscious underfunding by the sponsoring government for whatever reason. We need to abandon the false notion that, if only we would produce, or would have produced, more or different numbers, the underfunding would go away, or would never have existed.

In my view, new ASOPs for public plans will not help and will in fact be a divisive distraction that will delay progress in achieving our objectives.

Once again, thank you for the opportunity to comment on these matters.

Sincerely,

Brian B. Murphy, FSA, EA, FCA, MAAA, PhD
President

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